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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 001789

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SUBJECT: AZERBAIJAN: BP WILLING TO MAXIMIZE ACG GAS TO
SOCAR TO HELP MEET SHORT-TERM GAS CRUNCH

Classified By: Ambassador Anne E. Derse, Reasons 1.4 (b,d)

¶1. SUMMARY: BP Azerbaijan President Bill Schrader told the Ambassador on December 8 that BP has come up with a proposed course of action to help Azerbaijan out of its upcoming winter gas supply shortage, part of which would be giving Azerbaijan "as much ACG associated gas as it can" over a six to eight week period. He would also tell President Aliyev that this excess free gas would stop 'come April,' when the crisis was over, and Azerbaijan should not get used to it -- it was essential to re-inject this gas to preserve the health and production of the ACG field. BP would not seek compensation for any losses incurred by this extra ACG gas to Azerbaijan. According to demand numbers agreed to by both BP and SOCAR, Schrader said that Azerbaijan would be able to get through the winter even without any gas from Russia, and would be able to give as much gas to Georgia as Georgia is technically able to receive, replacing it with mazut in Azerbaijani power plants. END SUMMARY.

¶2. (U) On December 8 the Ambassador met with BP Azerbaijan President Bill Schrader to discuss the upcoming regional gas situation. BP External Affairs Director Clare Bebbington and EnergyOff (notetaker) were also present.

¶3. (C) Schrader said that he and his staff had been working 'nonstop' over the previous 36 hours to arrive at a solution for Azerbaijan's upcoming winter 2007 gas shortage. The proposed solution, which Schrader will seek to deliver to President Aliyev this weekend, is predicated upon three assumptions:

- the key months are January through March 2007.
- Turkey will not be able to take any Shah Deniz gas until at least April 2007 (Schrader said that BP's "guys with binoculars" had made this assessment after looking at the pipeline construction in Turkey)
- BP's Shah Deniz producing wells come on schedule.

¶4. (C) Schrader said that he was seeking a meeting with President Aliyev on December 9 to tell him that BP was willing to forego BP's optimal gas reinjection schedule and instead maximize delivery of associated gas from the ACG field for six to eight weeks this winter to the extent allowable by the existing infrastructure - "We're going to push as much gas at them as they can take." Additionally, he would not ask "to be made whole" for any losses stemming from giving this increased amount of ACG gas to Azerbaijan. However, he said he would also tell Aliyev that that this is a good-faith short-term effort by BP to help Azerbaijan out of a tough situation, but that "come April, the free gas will

stop," i.e. Azerbaijan should not expect these additional amounts of free ACG associated gas to continue. Schrader would point out to Aliyev that maintaining the reinjection schedule over the long-term was essential to preserve the ACG field's health and productive ability. He added that it was by no means certain that BP's partners in Shah Deniz would be pleased with this proposal, as heretofore they had always asked to be 'made whole' by any increased transmission of associated ACG gas to Azerbaijan.

¶5. (C) In this regard, Schrader explained that BP's reluctance to agree to giving increased amounts of ACG gas to Azerbaijan stemmed from their concern that Azerbaijan would "get used" to this free gas (note: Many GOAJ interlocutors, to include President Aliyev and FinMin Sharifov, have told the Ambassador that BP's unwillingness to give increased amounts of ACG associated gas stemmed from BP's desire to 'link' this issue with access to ACG deep gas, or extension of the current PSA). Schrader said that he was aware that many in the Azerbaijan government ascribed sinister motives to BP's reluctance to help out with additional ACG associated gas, but that he would tell Aliyev frankly that BP was not seeking to "blackmail Azerbaijan over ACG deep gas," but that it was concerned about Azerbaijan "getting used to" free ACG gas.

¶6. (C) Responding to the claim by some GOAJ officials that BP could maintain well pressure by reinjecting water, Schrader explained that optimal reserve recovery is predicated on both water and gas re-injection, water for the aquifer below the oil, and gas for the wellhead gas sitting above the oil. Reinjecting merely water and not adequate gas would result in decreased reservoir pressure and sub-optimal reserves recovery. Longer term non-adherence of the ACG gas

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reinjection schedule could also increase the chance of water 'fingering' into the oil being extracted, which would lead to well shut-down, drilling of a sidetrack well (cost: approximately 20 million USD), and other attendant financial losses. Responding to the charge that BP is continuing to flare significant amounts of gas, Schrader said that the previous week there had been an 'inexplicable' arcing out and consequent explosion of an 11 thousand ABB volt breaker at the platform, which caused loss of power generation to compressors and the resultant necessary flaring of 100 million scf/d. He said this problem should be solved by next week, with the flaring ended. He said that GOAJ security (MNS) suspected sabotage, and was seeking to investigate.

¶7. (C) Schrader said that he was seeking to see Aliyev the following day, as he "did not want to be called on the carpet" at a proposed December 14 'Trilateral plus Two' meeting in Baku, about which he had heard from BP in Washington.

¶8. (C) Concerning the recent Turkish announcement to BP that it is ready to receive Shah Deniz gas, Schrader said that BP "doesn't" want to be in the middle of a 'take or pay' fight between Azerbaijan and Turkey, and would let the two countries decide. Schrader said that BP's proposed solution sought to address Azerbaijan's gas supply shortage for the coming winter, with the realization that Azerbaijan could use this revised gas balance in winter 2007 to send Georgia as much gas as it could technically be able to receive from Azerbaijan.

Shah Deniz Wells

¶9. (C) Schrader said that the first Shah Deniz well should begin production the week of December 11, and should be producing approximately 230 million standard cubic feet per day (scf/d - equal to 2.3 billion cubic meters annually - bcm/a). The second Shah Deniz well, estimated to produce an equivalent amount, will begin production in mid-January 2007,

with the two wells eventually producing a total of 460 million scf/d (4.6 bcm/a). He predicted the third Shah Deniz well will begin production in mid-March 07.

January Supply-Demand

¶10. (C) Schrader said that BP sees the solution to the problem of the upcoming winter 07 gas shortage on a month-to-month basis, and that their calculations showed that January would be the most difficult month. However, he said that the proposal BP would put forward would meet the need even in January. Schrader gave the following numbers to the Ambassador, pointing out that this demand projection had been agreed to in the joint BP-SOCAR Working Group:

Azerbaijan Demand in January 2007:	1350 million scf/d
Available from storage:	300 million scf/d
SOCAR produces:	420 million scf/d
ACG Associated Gas:	290 million scf/d
Shah Deniz Well #1 Gas:	230 million scf/d
Shah Deniz Well #2 Gas (month avg):	115 million scf/d
Total Supply in January 2007:	1355 million scf/d

¶11. (C) When asked about Georgia's gas needs, Schrader said that BP estimated that in January 07 the most Georgia could receive from Azerbaijan was 180 million scf/d (1.8 bcm/a). According to Schrader, Azerbaijan could "easily" send this amount to Georgia and make up for the loss by increased burning of mazut in its power plants. He pointed out that Georgia could also burn increased mazut in its power plants.

Russia

¶12. (C) BP's projections assumed zero gas from Russia. Schrader said that in his opinion Azerbaijan was right not to accept gas from Russia at USD 230 per mcm, as this price once accepted would become a new benchmark below which it was unlikely to drop. Referring to recent GOAJ announcement that

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it would forego using the Northern Supply Route for exporting oil, Schrader said that Russia would not only lose the tariffs, but that without Azeri light to mix with in the pipeline, its own Ural blend would become that much less commercially desirable. Concerning the currently shut-down for repairs Western Supply Pipeline to Supsa, Schrader said that it should be back on line by late December, early January 2007.

¶13. (C) Schrader said that according to BP's calculations, the gas crunch problem would by and large be over by April 2007, adding that Shah Deniz would be producing at excess of demand for the rest of 2007. When the Ambassador asked for the reason in Shah Deniz production delays, Schrader said that pressure testing of a new wellhead design on the TPM-500 platform had gone awry, causing a two to three month delay in production.

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